

## Message Text

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TREASURY:PO'CONNELL:RSELF (SUBS.)

EB/OT/STA:JSPIRO

EB/ITP:WBARRACLOUGH

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TO AMEMBASSY MADRID

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USOECD

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TAGS: ECON, ETRD, SP, PFOR

SUBJECT: SECOND MEETING OF US-SPAIN JOINT ECONOMIC

COMMITTEE MEETING

REF: STATE 20823

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1. SUMMARY: THE SECOND MEETING OF THE US-SPAIN JOINT ECONOMIC COMMITTEE WAS HELD JANUARY 19. THE SPANISH DELEGATION REVIEWED SPAIN'S ECONOMIC SITUATION AND ITS PROSPECTS FOR IMPROVEMENT IN 1978 AS A RESULT OF GOS INITIATIVES TO REDUCE THE BALANCE-OF-PAYMENTS DEFICIT, LOWER THE RATE OF INFLATION, AND REDUCE UNEMPLOYMENT. THE SPANISH REQUESTED: (1) SPECIAL QUOTAS FOR STAINLESS STEEL BAR AND ALLOY TOOL STEEL; (2) REMOVAL OF US COUNTERVAILING DUTIES APPLIED TO FIVE SPANISH PRODUCTS; AND, (3) AN INCREASED BYCATCH IN US WATERS. WE INFORMED THE SPANISH THAT WE MAY BE ABLE

TO RESPOND FAVORABLY TO THEIR REQUESTS. SPANISH ALSO OFFERED TO SEND A SENIOR OFFICIAL TO WASHINGTON TO DISCUSS SPECIFIC AREAS OF US-SPANISH COOPERATION ON NORTH/SOUTH ISSUES. THE MEETING WAS CORDIAL AND PROVIDED AN OPPORTUNITY FOR HIGH-LEVEL EXCHANGE OF VIEWS. END SUMMARY.

2. THE SECOND MEETING OF THE US-SPAIN JOINT ECONOMIC COMMITTEE ESTABLISHED UNDER THE 1976 TREATY OF FRIENDSHIP AND COOPERATION WAS HELD JANUARY 19 AND CO-CHAIRED BY ASSISTANT SECRETARY OF STATE JULIUS KATZ AND CARLOS GAMIR, DIRECTOR GENERAL OF INTERNATIONAL ECONOMIC RELATIONS, FOREIGN MINISTRY OF SPAIN. THREE DAYS OF WORKING GROUP DISCUSSIONS BETWEEN SPANISH AND US OFFICIALS PRECEDED THE MEETING.

3. SPANISH ECONOMY: GAMIR OPENED THE MEETING WITH A DETAILED PRESENTATION ON THE SPANISH ECONOMY AND RECENT GOS MEASURES DIRECTED AT ALLEVIATING SPAIN'S MOST PRESSING ECONOMIC DIFFICULTIES (THE BALANCE OF PAYMENTS DEFICIT, A HIGH RATE OF INFLATION, AND UNEMPLOYMENT IN SENSITIVE INDUSTRIES).

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4. GAMIR POINTED OUT THAT MANY OF SPAIN'S CURRENT ECONOMIC PROBLEMS DATED FROM THE UNPRECEDENTED INCREASE IN OIL PRICES IN 1973-1974. IN MID-1977, INFLATION WAS RUNNING AT AN APPROXIMATE ANNUAL RATE OF 30 PERCENT, THE CURRENT ACCOUNT WAS HEADED TOWARD A 5 BILLION DOLLAR DEFICIT BY THE END OF THE YEAR, AND THE UNEMPLOYMENT RATE WAS APPROXIMATELY 5.5 PERCENT, THUS REQUIRING THE GOS TO MAKE LARGE AND UNFORESEEN OUTLAYS FOR UNEMPLOYMENT COMPENSATION. GAMIR POINTED OUT THAT STRUCTURAL RIGIDITIES IN THE SPANISH ECONOMY (REGRESSIVE TAXATION, A FINANCIAL SYSTEM UNRESPONSIVE TO MARKET CONDITIONS, AND A REGRESSIVE SOCIAL SECURITY SYSTEM) HAVE MADE ECONOMIC REFORM MORE DIFFICULT AND MORE PRESSING. THE JUNE 1977 ELECTIONS, HE CONTINUED, HAD FINALLY GIVEN THE SPANISH GOVERNMENT SUFFICIENT POPULAR BACKING TO TAKE THE MEASURES NECESSARY TO CONFRONT THE DECLINING ECONOMIC SITUATION.

5. ECONOMY MINISTRY REPRESENTATIVE MORAL OUTLINED THE SHORT-TERM MEASURES THE GOS WILL TAKE TO CONFRONT ITS ECONOMIC DIFFICULTIES. THE GOS MEASURES, HE SAID, WERE DIRECTED AT ESTABLISHING A MODERN FREE-MARKET ECONOMY:

(A) A RESTRICTIVE MONETARY POLICY THROUGHOUT 1978. GROWTH IN THE MONEY IS TARGETED AT 17 PERCENT IN 1978 FOLLOWING INCREASES IN 1976 AND 1977 OF 19.3 PERCENT AND 18.7, RESPECTIVELY.

(B) STRONG GOVERNMENTAL SANCTIONS APPLIED TO BOTH BUSINESS AND LABOR, LIMITING WAGE INCREASES TO 22 PERCENT FOR 1978. RECENTLY NEGOTIATED CONTRACTS IN LEADING INDUSTRIES INDICATE THAT THE GOS'S TARGET WILL BE MET OR BETTERED.

(C) A STABLE LEVEL OF GOVERNMENT SPENDING CHANNELED TOWARD INVESTMENT AND ASSUMPTION OF A GREATER PERCENTAGE OF THE SOCIAL SECURITY BUDGET.

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(D) FLOATING THE PESETA FOLLOWING THE 20 PERCENT DEVALUATION IN JULY.

6. MORAL ALSO OUTLINED LONG-TERM MEASURES UNDER CONSIDERATION TO CONFRONT THE STRUCTURAL RIGIDITIES IN THE SPANISH ECONOMY:

(A) A FAR-REACHING TAX REFORM PACKAGE, INCLUDING REVISIONS OF PERSONAL, CORPORATE, AND INHERITANCE TAXES. GAMIR NOTED SPAIN WAS ALSO CONSIDERING A VALUE-ADDED TAX, WHICH COULD ALLEVIATE THE ONGOING DISPUTE REGARDING THE US'S IMPOSITION OF COUNTERVAILING DUTIES.

(B) FINANCIAL REFORMS INCLUDING RELAXATION OF INTEREST RATE CONTROLS ON TIME DEPOSITS AND GOVERNMENT LOANS TO THE BANKING SECTOR AND RELAXATION OF RESERVE REQUIREMENTS.

(C) A FULL-SCALE ENERGY PROGRAM - DETAILS ARE STILL PENDING IN THE SPANISH GOVERNMENT.

7. MR. GAMIR NOTED THAT THE ECONOMIC REFORM PACKAGE COULD JEOPARDIZE ECONOMICALLY-SENSITIVE SECTORS SUCH AS STEEL, MACHINERY, AND ENERGY. THESE INDUSTRIES, HE EXPLAINED, HAD PREVIOUSLY OBTAINED FINANCING AT LOWER-THAN-MARKET RATES OF INTEREST AND WOULD NOW BE FORCED TO PAY MARKET RATES. HE CONCLUDED THAT THE GOS WOULD HAVE TO WALK A NARROW LINE TO AVOID DAMAGING THESE INDUSTRIES IN THE PROCESS OF ECONOMIC REFORM AND THUS EXACERBATING RATHER THAN IMPROVING SPAIN'S ECONOMIC SITUATION.

8. KATZ ASKED ABOUT SPANISH PROJECTIONS FOR THEIR BALANCE OF PAYMENTS IN 1977. MORAL PREDICTED A 13-14 PERCENT

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INCREASE IN EXPORTS AND A 1 PERCENT INCREASE IN IMPORTS.

KATZ ASKED WHAT ASSUMPTIONS REGARDING RATES OF GROWTH IN EUROPE HAD BEEN USED IN THE SPANISH PROJECTIONS. MORAL

REPLIED THAT AN INCREASED RATE OF RECOVERY IN EUROPE WOULD HAVE A FAVORABLE IMPACT ON SPAIN'S BALANCE OF PAYMENTS.

9. MULTILATERAL ECONOMIC ISSUES: MTN: KATZ INFORMED THE SPANISH THAT THE US WILL TABLE A BOLD AND FORTHCOMING MTN OFFER (OFFERS WERE TABLED JANUARY 23). THE UNITED STATES, HE SAID, CONSIDERS THE MTN IMPORTANT TO CONTAIN INCREASING PROTECTIONISM IN THE WORLD AND TO REDUCE DISTORTIONS IN WORLD TRADE, THE LATTER GOAL PARTICULARLY IMPORTANT GIVEN THE USE OF FLOATING EXCHANGE RATES. KATZ URGED THE SPANISH TO PARTICIPATE IN THE MTN BECAUSE MAINTENANCE OF OUR OFFER WILL REQUIRE RECIPROCITY FROM MAJOR AND SECONDARY SUPPLIERS AND THE MTN OBJECTIVE OF FREER TRADE WILL AID THE SPANISH ECONOMY. GAMIR RESPONDED THAT HE COULD NOT PREDICT WHAT ACTIONS SPAIN'S

PARLIAMENT WOULD TAKE REGARDING THE MTN.

10. NORTH/SOUTH ISSUES: KATZ EXPRESSED US CONCERN REGARDING THE DICHOTOMY OF THE RHETORIC IN INTERNATIONAL FORA AND VIEWS EXPRESSED BILATERALLY WITH THE UNITED STATES. KATZ POINTED OUT THAT THE RHETORIC INTERFERES WITH THE GOALS OF BOTH LDC'S AND DC'S AND LEADS TO INCREASING FRUSTRATION AND BITTERNESS. (FYI: THE SPECIFIC ISSUE OF SPAIN'S RECENT INCONSISTENT POSITION ON THE COMMON FUND WAS NOT ADDRESSED.) KATZ ASKED THE SPANISH TO HELP MODERATE LDC POSITIONS. GAMIR RESPONDED THAT HE WAS NOT AN EXPERT ON LDC ISSUES AND OFFERED TO SEND HIS DEPUTY TO MEET WITH APPROPRIATE US OFFICIALS TO DISCUSS THE POSSIBILITY OF GREATER US-SPANISH COOPERATION ON SPECIFIC NORTH/SOUTH ISSUES. KATZ NOTED THAT SUCH A SERIOUS DIALOGUE WOULD BE A HELPFUL DEVELOPMENT.

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11. INCOME TAX TREATY: GAMIR NOTED THAT THE SPANISH DELEGATION HAD INFORMED APPROPRIATE TREASURY OFFICIALS DURING THE WEEK THAT NEGOTIATIONS ON THE PENDING INCOME TAX TREATY COULD BE RESUMED IN THE SUMMER. SPAIN'S TAX REFORM PACKAGE, HE EXPLAINED, WILL AFFECT TERMS OF THE TREATY.

12. BILATERAL ECONOMIC MATTERS: GAMIR PRESENTED A PAPER OUTLINING SPAIN'S TRADING RELATIONSHIP WITH THE UNITED STATES. CORTES, COMMERCIAL COUNSELOR OF THE SPANISH EMBASSY, REVIEWED THE STRUCTURE OF SPANISH-US TRADE, NOTING SPAIN'S HIGH LEVEL OF IMPORTS OF US PRODUCTS AND SPAIN'S PERSISTENT TRADE DEFICIT WITH THE UNITED STATES. CORTES SAID THAT ALTHOUGH SPAIN DID NOT BELIEVE IN BILATERAL BALANCING, THE CHANCES FOR REDUCING SPAIN'S IMPORTS FROM THE US WERE SMALL, WHILE PROSPECTS FOR INCREASED EXPORTS

TO THE UNITED STATES SOMETIMES SEEMED BLOCKED BY US POLICIES. KATZ REPLIED THAT HE WAS GLAD THAT THE SPANISH DID NOT BELIEVE IN BILATERAL BALANCING. HE ADDED THAT WORLDWIDE ECONOMIC RECOVERY WOULD BE INSTRUMENTAL IN ALLEVIATING SOME OF THESE SPECIFIC, NAGGING PROBLEMS IN WORLD TRADE.

13. SPECIALTY STEEL QUOTAS: CORTES REVIEWED SPAIN'S REQUESTS FOR INDIVIDUAL IMPORT QUOTAS FOR SPANISH-PRODUCED STAINLESS STEEL BAR AND ALLOY TOOL STEEL. HE POINTED OUT SPAIN WAS A MAJOR SUPPLIER OF STAINLESS STEEL BAR AND THAT OTHER, LESS SUBSTANTIAL SUPPLIERS (SUCH AS CANADA AND THE EC) HAVE OBTAINED SEPARATE QUOTAS. REGARDING A SEPARATE QUOTA FOR ALLOY TOOL STEEL, CORTES POINTED OUT THAT EXPORTS OF THIS COMMODITY HAVE DROPPED TO 147 TONS IN 1976 UNDER THE BASKET QUOTA FROM THE 1971-1975 AVERAGE OF 475 TONS. KATZ REPLIED THAT WE WOULD CONSIDER SPANISH REQUESTS  
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CAREFULLY, BUT THAT A SEPARATE QUOTA FOR STAINLESS STEEL BAR IS MORE LIKELY THAN ONE FOR ALLOY TOOL STEEL. KATZ INDICATED THAT THE US WOULD ATTEMPT TO RESPOND TO SPANISH REQUESTS WITHIN A FEW WEEKS.

14. COUNTERVAILING DUTIES: GAMIR SAID SPANISH REQUESTS FOR REVISION OF US COUNTERVAILING DUTIES APPLIED AGAINST FIVE SPANISH PRODUCTS HAD BEEN DISCUSSED DURING THE WEEK WITH THE TREASURY DEPARTMENT, AND THE TREASURY REPRESENTATIVE HAD INDICATED THAT A RESPONSE WOULD BE FORTHCOMING WITHIN FOUR TO SIX WEEKS. KATZ CONCLUDED THAT ULTIMATELY THE PROBLEM OF COUNTERVAILING DUTIES COULD ONLY BE CONFRONTED THROUGH WIDE-RANGING SPANISH TAX REFORM, BUT THAT IT WAS HIS UNDERSTANDING THAT TREASURY WAS PREPARED TO STUDY NEW INFORMATION SUBMITTED BY THE GOS WHICH, IF ACCEPTED BY TREASURY, WOULD SUBSTANTIALLY REDUCE THE COUNTERVAILING DUTIES ON THE FIVE PRODUCTS.

15. SOYBEAN OIL: CORTES AND SPANISH COMMERCIAL ATTACHE MARTINEZ DEFENDED THE RESTRICTION ON SOYBEAN OIL CONSUMPTION FOR THE FOLLOWING REASONS: (1) US SOYBEAN EXPORTS HAVE INCREASED IN VALUE IN THE PAST 3 YEARS; (2) THE ESTABLISHMENT OF CONSUMPTION LEVELS FOR SOYBEAN OIL IS AN INTERNAL MATTER, COMPARABLE TO US HEALTH AND SANITARY REQUIREMENTS FOR IMPORTED GOODS; (3) THE RESTRICTION DOES NOT VIOLATE SPAIN'S GATT OBLIGATIONS SINCE THE SPAIN'S PROTOCOL OF ACCESSION TO THE GATT (1963) CONTAINS A GRANDFATHER CLAUSE, AND THE POLICY AFFECTING INTERNAL CONSUMPTION OF OILS WAS IN EFFECT BEFORE 1963. KATZ AND USDA REP REPLIED THAT US EXPORTS MIGHT HAVE BEEN GREATER WITHOUT THE RESTRICTIVE REGULATIONS AND THAT RESTRICTIONS FOR HEALTH REASONS ARE NOT SIMILAR TO TRADE

BARRIERS WHICH PROTECT DOMESTIC INDUSTRY; KATZ ASKED THE SPANISH DELEGATION IF SUCH A LAW HAD BEEN IN EFFECT WHEN SPAIN JOINED THE GATT. (FYI: IT WAS NEVER DETERMINED WHETHER THE SPANISH DID HAVE A LAW RESTRICTING CONSUMPTION

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OF SOYBEAN OIL IN 1963.) KATZ NOTED THAT THE UNITED STATES WOULD LIKE THE SPANISH TO REVIEW THE POSSIBILITY OF REMOVING OR REDUCING THE RESTRICTION, SINCE THE RESTRICTION MIGHT AFFECT US TREATMENT OF PRODUCTS OF INTEREST TO SPAIN IN THE MTN.

16. FISHERIES: GAMIR EXPRESSED HIS CONCERN REGARDING THE IMPACT OF BYCATCH REGULATIONS ON SPANISH FISHERMEN AND ASKED THAT THE US FAVORABLY CONSIDER SPAIN'S REQUEST FOR INCREASED BYCATCH. HE EMPHASIZED THAT SPAIN ATTACHED CONSIDERABLE IMPORTANCE TO THIS ISSUE. OES REP NOTED THAT THE US MAY BE ABLE TO INCREASE THE SIZE OF SPAIN'S ALLOWABLE FISHING AREA AND THUS ALLEVIATE THE PROBLEM OF LIMITED BYCATCH BY PROVIDING FLEXIBILITY OF MOVEMENT. HE ADDED THAT FISHERIES ALLOCATIONS ARE PREPARED BY REGIONAL COUNCILS, COMPRISED OF INDUSTRY AND GOVERNMENT REPRESENTATIVES.

17. EXIMBANK: GAMIR REFERRED BRIEFLY TO THE MEETING BETWEEN SPANISH REPRESENTATIVES AND THE EXIMBANK LOAN OFFICER FOR SPAIN. HE NOTED WITH PLEASURE THAT OTHER SPANISH INDUSTRIES (IN ADDITION TO THE HEAVILY EXIMBANK-FINANCED NUCLEAR INDUSTRY) WILL HAVE ACCESS TO INCREASED EXIMBANK FINANCING.

18. ENERGY: GAMIR INFORMED THE COMMITTEE THAT THE SPANISH ENERGY PROGRAM IS STILL IN THE PRELIMINARY STAGES, AND HE WAS THEREFORE UNABLE TO PRESENT ANY DETAILS. KATZ POINTED OUT THAT CONGRESS HAS AGREED ON MANY IMPORTANT POINTS IN THE PRESIDENT'S ENERGY PROGRAM BUT THAT DETERMINATION OF THE APPROPRIATE PRICING FOR NATURAL GAS IS DELAYING APPROVAL OF THE PROGRAM. HE CONCLUDED THAT THE PRESIDENT

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WAS DETERMINED TO MOVE RAPIDLY TO RESOLVE ENERGY ISSUES.

19. THE MEETING ENDED ON A CORDIAL NOTE. BOTH SIDES AGREED THAT THE MEETING WAS HELPFUL IN FOCUSING HIGH-LEVEL ATTENTION ON AREAS OF MUTUAL CONCERN. VANCE

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